IN THE

Supreme Court of the United States

OCTOBER TERM, 1976

No. 76-909

THE CITIZENS AND SOUTHERN NATIONAL BANK,
Petitioner,

versus

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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The Citizens and Southern National Bank, (herein "Bank") (The Respondent shall be herein "Government".) prays that a writ of certiorari issue to the United States Court of Appeals Fifth Circuit to review the judgment of that Court entered in Case No. 75-3571 on September 15, 1976. A petition for rehearing was denied on November 16, 1976. These rulings dealt with this case and a companion case, No. 75-2549. A separate petition for writ of certiorari is being filed in Case No. 75-2549. The allegations of the petition for certiorari in Case No. 75-2549 are adopted herein.

OPINIONS BELOW

The opinion of the court below (Appendix p. 1a) is reported at 538 F. 2d 1211, 76-2 U.S.T.C. ¶ 9665. It reversed the District Court for the Middle District of Georgia (Appendix p. 16a) (apparently reported only in 75-2 U.S.T.C. ¶ 9652.)

JURISDICTION

The judgment of the court below (Appendix p. 24a) was entered September 15, 1976. A petition for rehearing was denied November 16, 1976 (Appendix p. 25a) Mandate has been stayed to and including January 5, 1977. Jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

While the Court of Appeals erred in several material respects, there are two questions of surpassing importance:

1. Whether the Court of Appeals emasculated the Tax Lien Act of 1966 (28 U.S.C. 6323) and thereby frustrated the will of Congress in holding that the Government's subsequently asserted tax lien was valid as against the Bank's admittedly existing security interest.

2. Whether, when the District Court because of its disposition of the case found it unnecessary to rule on constitutional issues raised by the Bank, the Court of Appeals should remand the case with direction to en-

ter judgment for the Government, thereby foreclosing any ruling upon the constitutional questions.

STATUTES INVOLVED

Internal Revenue Code of 1954 (26 U.S.C.):

Section 6321 which creates a lien for federal taxes on all property and rights to property of a taxpayer.

Section 6323(a) and (h) which provides that a federal tax lien shall not be valid as against the holder of a security interest.

Section 6331(a) which provides for levy and distraint for federal taxes without prior notice.

Section 6332(a) which requires immediate surrender of property levied.

Section 85-1803, Georgia Code Annotated, which provides for assignability of choses in action.

Appendix pp. 26a-30a

STATEMENT OF THE CASE

B & G Wrecker Service, Inc. (herein "B & G") obtained a loan from the Bank on March 20, 1968. On the same date, it executed five security agreements giving the Bank a security interest in certain assets, and

opened a bank account the deposit agreement for which included the following language:

> "To secure any and all indebtedness and liability of Depositor to Bank, however and whenever incurred or evidenced, whether direct or indirect, absolute or contingent, due or to become due, Depositor hereby transfers and conveys to Bank all balances, credits, deposits, monies and items now or hereafter in this account and Bank is authorized at any time to charge such indebtedness or liability against this account whether or not the same is then due . . ."

On April 22, 1968, the first installment on the loan was payable. Neither it nor any other installment payment was timely paid. All credits to the loan after April 22, 1969 resulted from application by the Bank of funds in the bank account or by foreclosure upon other collateral. At all times after April 22, 1969, the debt was mature and demandable.

On June 10, 1969, the government assessed withholding and FICA taxes against B & G for periods beginning with the third quarter of 1968. On June 23, 1969, a notice of levy against the bank account of B & G was served on the Bank. At the time of the levy, there was on deposit in the bank account the sum of $1,977.38. On the same day, the Bank set off the balance in the bank account against the indebtedness. At all times material hereto, B & G was indebted to the Bank in a sum in excess of the amount on deposit and the Bank sustained a loss because the liquidation of

the collateral, including the setoff of the checking account, was insufficient to pay the balance due. Neither the Government nor the Bank has been paid the sums due by B & G.

On March 22, 1974, the Government sued the Bank because of the latter's refusal to pay the money in the bank account to the former. The Bank defended, alternatively, on several grounds. These included:

1. Under Georgia law, both by operation of law and by contract, the Bank had a security interest in the bank account which was created prior to the tax lien and that under the Tax Lien Act of 1966 (26 U.S.C. 6323 (Appendix p. 27a)), the tax lien was invalid and inferior.

The District Court agreed with this position; the Circuit Court of Appeals reversed.

2. If, as the Government contended, a bank account is property or right to property subject to a federal tax lien (the Bank also contending alternatively to the contrary), then by virtue of the deposit agreement as well as by operation of Georgia law, the Bank had a property interest therein and the summary seizure of that property interest by the Government would violate the Fifth Amendment of the Constitution by taking property belonging to the Bank without due process of law.

The District Court, because it held the Government's lien to be invalid as against the Bank did not reach this question. In remanding the case to the District Court

with direction that it enter judgment for the Government, the Court of Appeals did not deal with it either.

REASONS FOR GRANTING THE WRIT

This petition raises substantial and important questions of national interest in the administration of the federal tax laws. The Court of Appeals failed to give effect to Georgia law and thereby violated the precepts of *Aquilino vs. United States*, 363 U.S. 509, 80 S.Ct. 1277, 4 L.Ed. 2d 1365 (1960).

It was clearly the intent of Congress in enacting the Federal Tax Lien Act of 1966 to protect holders of security interests in collateral as against federal tax liens. The holding of the Court of Appeals completely frustrates the intent and purpose of the Federal Tax Lien Act of 1966 (26 U.S.C. 6323 (Appendix p. 27a)), and if allowed to stand will result in an emasculation of that act in that, notwithstanding the statute, the Court of Appeals has held that a federal tax lien is valid as against a previously created security interest.

Finally, the decision of the Court of Appeals has deprived the Bank of a hearing on the constitutional issues which it raised. No court has apparently had the occasion to consider the constitutional issues in a tax setting where the question was raised by a secured creditor. The Bank is entitled to have these issues decided but is precluded by the remand with direction.

Thus, the Court of Appeals has created great uncertainty as to the rights of secured third party creditors

contrary to manifest Congressional intent and has precluded a ruling on a constitutional question of first impression. The need for certainty as to creditors' rights in tax lien situations is of great importance nationwide, and the constitutional questions here raised are substantial and should be decided.

ARGUMENT AND CITATION OF AUTHORITY

Whether The Court Of Appeals Emasculated The Tax Lien Act Of 1966 (28 U.S.C. 6323) And Thereby Frustrated The Will Of Congress In Holding That The Government's Subsequently Asserted Tax Lien Was Valid As Against The Bank's Admittedly Existing Security Interest.

In *Aquilino vs. United States*, 363 U.S. 509, 80 S.Ct. 1277, 4 L.Ed. 2d 1365 (1960), this Court held that whether and to what extent a taxpayer has property or rights to property to which a tax lien can attach is a matter of local law.

The Court of Appeals failed to apply both case and statute law of Georgia. If, as the government contends, a depositor has a property interest in a bank account, it is of necessity a chose in action. Section 85-1803, Georgia Code Annotated (Appendix p. 30a), provides that choses in action arising upon contract are assignable so as to vest title in the assignee. In *Macon National Bank vs. Smith*, 170 Ga. 332, 153 S.E. 4 (1930), an assignment of a bank account made in a deposit agreement vested title to the account in the assignee so as to give him preference over a garnishing

creditor. Of similar import is *Georgia Bank & Trust Company vs. Hadarits*, 221 Ga. 125, 143 S.E. 2d 627 (1965). Thus, under Georgia law, it is clear that the Bank had at least a security interest in the bank account. The facts in the present case were stipulated and it is important to note that it was expressly stipulated that the checking account secured the indebtedness of B & G to the Bank and that a security interest in the Bank was created by the deposit agreement. Thus, under the stipulation, the Georgia law was really not at issue, though, if applied, demanded a contrary result.

The Tax Lien Act of 1966 (?3 U.S.C. 6323) (Appendix p. 27a) evidences the intent of Congress that holders of security interests shall be protected as against federal tax liens. The Senate Finance Committee in its report on the Act said in part:

> "The adverse effect of the pre-1966 tax rules caused the Congress to pass the Federal Tax Lien Act of 1966 and to make clear that Congress intended that in affording certainty and protection to bona fide creditors in commercial settings, their interests would be protected. . . . It permits lenders to finance the operation of commercial transactions with some certainty that they will not lose simply because thereafter, the debtor may become delinquent in his obligations to the federal government."

In its explanation of the bill, the Senate Finance Committee said in part:

> "Under the bill, persons to be accorded priority over a tax lien include purchasers, judgment lien creditors, mechanics lienors and holders of security interests . . ."

The decision of the Court of Appeals frustrates the intent of the Congress and fails to give effect to the clear meaning and purpose of the Act. The decision relies upon certain pre-1966 bench law (or post-1966 bench law which failed to take into account the passage of the Act in holding that the question of lien priority may not be a defense in a case such as this. The question is not one of lien priority (although the Senate Finance Committee Report uses a similar phrase) but whether, under the statute the Government's tax lien is *valid* as against the Bank's security interest. As to this, the instant case seems of first impression. The Court of Appeals should have held that since the Bank admittedly had a security interest in the bank account, the tax lien was not valid as against it and thereby give proper construction to the Act.

Whether, When The District Court Because Of Its Disposition Of The Case Found It Unnecessary To Rule On Constitutional Issues Raised By The Bank, The Court Of Appeals Should Remand The Case With Direction To Enter Judgment For The Government, Thereby Foreclosing Any Ruling Upon The Constitutional Questions.

Of importance to the administration of justice in the United States is the action of the Court of Appeals in

summarily precluding constitutional claims made by the Bank.

In its opinion, the District Court (Appendix p. 23a) said that its disposition of the case "makes it unnecessary for the Court to give consideration to the constitutional questions raised by Defendant's answer and brief." The Court of Appeals said in reversing both cases (this case and the companion case) which were then before it:

> "The judgment in each case is reversed and the cases are remanded to the District Courts for entry of judgments for the government."

The constitutional questions are substantial. The Government has successfully contended that a bank account is property or a right to property to which a federal tax lien may attach. If a bank account is property or right to property, then it follows that a creditor can also acquire an interest therein and the parties have stipulated that one had been created in favor of the Bank. The decision of the Court of Appeals, first, deprives the Bank of its property (i.e., its security interest) without due process of law in violation of the Fifth Amendment; and, second, deprives it of any ruling on its contentions. The Government may not abrogate contract rights or take property without due process. *Louisville Joint Stock Land Bank vs. Radford*, 295 U.S. 555, 55 S.Ct. 854, 79 L.Ed. 1593 (1935); *Lynch vs. United States*, 292 U.S. 571, 54 S.Ct. 840, 78 L.Ed. 1434 (1934).

The relevant part of the Fifth Amendment to the Constitution of the United States reads:

> "No person shall be . . . deprived of . . . property, without due process of law . . ."

Sections 6331 and 6332 of the Internal Revenue Code (Appendix pp. 28a-30a) make no provision for notice or hearing, or an opportunity for either, before seizure of property under a tax lien in the hands of a third person.

The Court of Appeals' decision results in the Bank's property being taken without notice and without an opportunity for notice. As thus applied there is an unconstitutional deprivation of property. See *Bank of Marin vs. England*, 385 U.S. 99, 87 S.Ct. 274, 17 L.Ed. 2d 197 (1966). More recently, in a case striking down garnishment proceedings (to which the levy of a federal tax lien in circumstances similar to those here involved is strikingly apposite), this Court has said that garnishment statutes which authorize the seizure of money or property without an opportunity to be heard are unconstitutional. *Sniadach vs. Family Finance Corp. of Bay View*, 395 U.S. 337, 89 S.Ct. 1820, 23 L.Ed. 2d 349 (1969); *North Georgia Finishing, Inc. vs. Di-Chem, Inc.*, 419 U.S. 601, 95 S.Ct. 719, 42 L.Ed. 2d 751 (1975). Similarly, the summary procedures for the foreclosure of chattel mortgages violate the Constitution. *Fuentes vs. Shevin*, 407 U.S. 67, 92 S.Ct. 1983, 32 L.Ed. 2d 556 (1972).

The decision of the Court of Appeals not only fails to give effect to the decisions of this Court, but summarily deprives the Bank of the right to be heard on sub-

stantive claims. The Court of Appeals should have remanded the case to the District Court for a consideration of the constitutional questions. See, for example, *Johnson vs. Zerbst*, 304 U.S. 458, 58 S.Ct. 1019, 82 L.Ed. 1461 (1938); *Tunstall vs. Brotherhood of Locomotive Firemen and Enginemen*, 323 U.S. 210, 65 S.Ct. 235, 89 L.Ed. 187 (1944); and *Polizzi vs. Cowles Magazines, Inc.*, 345 U.S. 663, 73 S.Ct. 900, 97 L.Ed. 1331 (1953).

CONCLUSION

Applicant, for the reasons set forth not only in this application for writ of certiorari, but also that filed by Applicant in the proceedings ensuing from Case No. 75-2549, which is being filed contemporaneously herewith, urges that the Court's writ of certiorari should issue to review the judgment of the United States Court of Appeals Fifth Circuit and that upon review, the judgment of the Court of Appeals should be reversed.

Respectfully submitted,

E. S. SELL, JR.
Attorney for Applicant

CERTIFICATE OF SERVICE

GEORGIA, BIBB COUNTY.

I, E. S. SELL, JR., do hereby certify that I have served copies of the within and foregoing Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit on the Respondent United States by mailing copies thereof to Robert H. Bork, Solicitor General of the United States; Scott P. Crampton, Assistant Attorney General, and to Gilbert E. Andrews, Elmer J. Kelsey and Murray S. Horwitz, Attorneys, Tax Division, United States Department of Justice, Washington, D. C. 20530, as well as to Ronald T. Knight, United States Attorney, Post Office Box U, Macon, Georgia 31202, with postage prepaid in full compliance with the Federal Rules of Civil Procedure.

This ____ day of December, 1976.

_____

APPENDIX

UNITED STATES of America,
Plaintiff-Appellant,

v.

CITIZENS AND SOUTHERN
NATIONAL BANK,
Defendant-Appellee.

UNITED STATES of America,
Plaintiff-Appellant,

v.

CITIZENS AND SOUTHERN
NATIONAL BANK,
Defendant-Appellee.

Nos. 75-2549, 75-3571.

United States Court of Appeals,
Fifth Circuit.

Sept. 15, 1976.

Before WISDOM, GODBOLD and LIVELY*, Circuit Judges.

LIVELY, Circuit Judge.

In these two cases the government appeals from judgments in favor of banks which had refused to pay to the Internal Revenue Service the balances in bank accounts upon which levies were made for federal taxes previously assessed. In each instance the bank contended that the depositor-taxpayer in whose name the account stood had no property or rights to property in

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* Of the Sixth Circuit, sitting by designation.

the account either at the time of the assessment of taxes or the time of the levy. In each case the government brought suit to enforce the levy, and the district courts, on somewhat different reasoning, entered judgments for the banks (separate offices of Citizens and Southern).

Section 6321 of the Internal Revenue Code of 1954 (26 U.S.C. § 6321) creates a lien in favor of the United States "upon all property and rights to property, whether real or personal, belonging to . . ." a person liable for any tax who has not paid it after demand. Section 6331(a) of the Code (26 U.S.C. § 6331(a)) gives to the Secretary of the Treasury or his delegate authority "to collect such tax . . . by levy upon all property and rights to property . . . belonging to such person or on which there is a lien provided in this chapter for the payment of such tax."

The facts in both cases were stipulated. In No. 2549 the Internal Revenue Service (IRS) made an assessment for unpaid wagering excise taxes against Robert W. Best, a customer of Citizens and Southern National Bank (the bank), on May 2, 1973. At noon on May 3, 1973, when the checking account[1] of Best reflected a credit balance in excess of $57,000, officers of the bank determined that the bank was "insecure" with respect to indebtedness of Best to the bank in excess of $60,000 and determined to take all reasonable steps to protect the bank. At 3:05 p.m., May 3, 1973 an agent of IRS served a notice of levy directing the bank to surrender to

1 Best actually had several accounts, but the terms of the agreement with the bank were substantially the same on all, and a single account will be referred to for convenience.

the government the balance in the Best account. On May 4, 1973, the bank wrote Best that as of that date it had applied the balance in his account to his outstanding indebtedness to the bank. On May 8, 1973 the bank actually made the transfer entries, charging the Best account and crediting the Best notes.

Prior to the time of both the assessment and the levy Best had executed several promissory notes to the bank, each of which contained the following language:

> To secure the payment of this Note and all other indebtedness or liabilities of the undersigned to Holder, however and whenever incurred or evidenced, whether direct or indirect, absolute or contingent, or due or to become due (hereafter with this Note, collectively called "Liabilities"), undersigned transfers and conveys to Holder any and all balances, credits, deposits, accounts, items and monies of the undersigned now or hereafter with the Holder, and the undersigned agrees that the Holder shall have a lien upon, security title to and a security interest in all property of the undersigned of every kind and description now or hereafter in the possession or control of the Holder for any reason, including all dividends and distributions on or other rights in connection therewith.
>
> In the event of nonpayment when due of any amount payable on any Liabilities, or if the Holder shall feel insecure for any reason whatsoever (1) any and all Liabilities may, at the option of Holder and without demand or notice of any kind be

declared and thereupon immediately shall become due and payable, (2) the Holder may exercise from time to time any of the rights and remedies available to Holder under the Uniform Commercial Code as in effect at that time in Georgia, or otherwise available to Holder and (3) the Holder may, at any time, without demand or notice of any kind, appropriate and apply toward the payment of such Liabilities, and in such order of application as the Holder may from time to time elect, any balances, credits, deposits, accounts, items and monies of the undersigned with the Holder.

The "personal checking account signature form" which Best signed when the checking account was opened contained the following language:

Should Bank receive any process, summons, order, injunction, execution, distraint, levy, lien, or notice, "Process," which in Bank's opinion affects this deposit, Bank may, at its option and without liability, thereupon refuse to honor orders to pay or withdraw sums from this account and may either hold the balance herein until Process is disposed of to Bank's satisfaction, or pay the balance over to the source of the Process.

* * * * * *

To secure any and all indebtedness and liability of (either or both) Depositors to Bank, however and whenever incurred or evidenced, whether direct or indirect, absolute or contingent, due, or to become due. Depositors (jointly and severally)

> hereby transfer and convey to Bank all balances, credits, deposits, monies and items now or hereafter in this account and Bank is authorized at any time to charge such indebtedness or liability against this account, whether or not the same is then due, and Bank shall not be liable for dishonoring items where the making of such a charge results in there being insufficient funds in this account to honor such items.

The district court held that under Georgia law the relationship of a depositor to a bank is one of creditor and debtor and that funds which are deposited are transformed into a chose in action. The district Court further held that in Georgia a chose in action is property or rights to property within the meaning of 26 U.S.C. § 6321. However, the court entered judgment for the bank upon finding that, under Georgia law, the language quoted herein from the promissory note constituted an assignment of Best's chose in action as collateral security for the debts evidenced by these promissory notes and operated as a valid assignment of all Best's rights as creditor of the Bank, existing by reason of his deposits, until the notes were paid. *See Macon National Bank v. Smith*, 170 Ga. 332, 338, 153 S.E. 4 (1930). Thus, C & S was not in possession of property or rights to property of the taxpayer at the time it received notice of the tax levy. For this reason, it cannot be held liable under section 6332(c) for its failure to turn over the funds deposited in Best's account.

In a footnote the district court quoted the assignment language from the signature form and stated that it granted "similar contract rights" to the bank.

The taxpayer in No. 3571 is B&G Wrecker (B&G) which borrowed from the bank and opened a checking account on March 20, 1968. The collateral installment note which B&G executed provided that

> . . . the Holder may, at any time, without demand or notice of any kind, appropriate and apply toward the payment of such of the Liabilities, and in such order of application, as the Holder may from time to time elect, any balances, credits, deposits, accounts, items or monies of the undersigned with the Holder.

B&G also executed a "deposit agreement" which contained language substantially identical to that quoted from the personal checking account signature form in No. 2549. In addition B&G gave the bank other collateral for the loan.

On June 10, 1969 IRS made an assessment of taxes against B&G and on June 13th a tax lien was filed in the proper recorder's office. On June 23, 1969 a notice of levy with respect to the B&G account was served on the bank. Immediately thereafter the bank made a setoff, crediting the B&G note for the full amount of the balance then carried in its account.

The district court held that under Georgia law when a person makes a general deposit in a bank, title to the money immediately passes to the bank and "the depositor simply has a claim against the Bank, which claim is not considered 'property' or a 'right to property.' " The court further held that since B&G's indebtedness to the bank was greater than the sum on

deposit at the time of the levy "B&G had no claim of any nature which it could have successfully asserted against the Bank . . . ." Relying on *United States v. Bank of Shelby*, 68 F.2d 538 (5th Cir. 1934), the district court stated,

> . . . since the Government's lien rights are derivative of those of the depositor, the Government takes subject to the defenses and equities affecting the depositor so that even if the depositor has a claim, if it is not a claim which could have been maintained successfully by him, the Government is in no better position.

The court reasoned that the bank had both common law and statutory rights of setoff "and further, that this set-off could be made by the Bank either before it had knowledge of the Government's tax lien or after it became aware of it." The court concluded that the bank had "a contractual lien and security interest in the deposit which was created by the instruments taken by the Bank at the time the account was opened by the depositor." The district court found that the quoted language in the deposit agreement was a "specific transfer and conveyance of bank deposits as security for the loan by the Bank to B&G."

Our approach to the issues raised by these appeals has been chartered by the Supreme Court. In *Aquilino v. United States*, 363 U.S. 509, 512-14, 80 S.Ct. 1277, 1280, 4 L.Ed.2d 1365 (1960), the Court wrote:

> The threshold question in this case, as in all cases where the Federal Government asserts its

> tax lien, is whether and to what extent the taxpayer had "property" or "rights to property" to which the tax lien could attach. In answering that question, both federal and state courts must look to state law, for it has long been the rule that "in the application of a federal revenue act, state law controls in determining the nature of the legal interest which the taxpayer had in the property . . . sought to be reached by the statute." *Morgan v. Commissioner*, 309 U.S. 78, 82, 60 S.Ct. 424, 426, 84 L.Ed. 585. Thus, as we held only two Terms ago, Section 3670 "creates no property rights but merely attaches consequences, federally defined, to rights created under state law . . . ." *United States v. Bess*, 357 U.S. 51, 55, 78 S.Ct. 1054, 1057, 2 L.Ed.2d 1135. However, once the tax lien has attached to the taxpayer's state-created interests, we enter the province of federal law, which we have consistently held determines the priority of competing liens asserted against the taxpayer's "property" or "rights to property." (footnotes and citations omitted).

Thus we look first to the law of Georgia to determine whether Best and B&G had property or rights to property in their respective bank accounts at the time the government claims its tax liens attached.

It is settled law in Georgia that a person who places money in a bank on general deposit loses title to the money and becomes a creditor of the bank. *McGregor v. Battle*, 128 Ga. 577, 58 S.E. 28, 29 (1907). The funds which are deposited are transformed into a chose in action. *Macon National Bank v. Smith*, 170 Ga. 332, 153

S.E. 4, 6-7 (1930); *Ricks v. Broyles*, 78 Ga. 610, 3 S.E. 772, 773 (1887). This court stated in *Broday v. United States*, 455 F.2d 1097, 1099 (1972), ". . . once it has been determined under state law that the taxpayer owns property or rights to property, federal law is controlling for the purpose of determining whether a lien will attach to such property or rights to property." (citation omitted). Thus, having determined that a depositor in a Georgia bank is vested with a chose in action, we look to federal law to determine whether a chose in action is property or rights to property under §§ 6321 and 6331. In *United States v. Hubbell*, 323 F.2d 197, 200 (5th Cir. 1963), after noting that "State law controls in determining the nature of the legal interest . . ." of one against whom a tax lien is asserted, ". . . but federal law controls the consequences attaching thereto . . .," the court held that a chose in action is subject to levy as "property" or "right to property." *See also United States v. Metropolitan Life Insurance Co.*, 130 F.2d 149 (2d Cir. 1942); *United States v. Cohen*, 271 F.Supp. 709 (S.D.Fla. 1967).

The bank in No. 2549 argues that the levy in that case was ineffective because (1) Best had conveyed to the bank "a security interest in his legal and equitable rights to the funds on deposit," (2) that feeling itself insecure, the bank had determined to apply Best's balance against his indebtedness prior to the service of notice of levy and had effective control over the Best account until appropriate entries could be made and (3) that even if Best had property or rights to property, the security interest of the bank was superior to the government lien. Principal reliance is placed on *Macon National Bank v. Smith*, supra, and *Georgia*

Bank & Trust Co. v. Hadarits, 221 Ga. 125, 143 S.E.2d 627 (1965). In No. 3571 the chief argument of the bank is that where there are mutual debts between parties the claim of a delinquent debtor who owes more than he is owed is extinguished. Thus it is contended that B&G had no interest in the balance on deposit in its account, because the larger claim of the bank against him left him with no enforceable claim against the bank. *Meriwether v. Bird*, 9 Ga. 594 (1851), *Skrine v. Simmons*, 36 Ga. 402 (1861), and *Taylor v. Jordan*, 57 Ga.App. 285, 195 S.E. 215 (1938), are cited in support of this position.

Although the Supreme Court of Georgia held in *Macon National Bank*, supra, that a bank depositor retains a chose in action, it further found that the chose in action had been assigned to the bank as collateral for a debt which exceeded the balance on deposit. The bank as transferee was held entitled to a "preference" with respect to the balance in the depositor's account as against the claim of a creditor who served a garnishment subsequent to the assignment. In *Georgia Bank & Trust Co. v. Hadarits*, supra, a bank to which a depositor had assigned all balances in his account as security for a note was held to have been "invested with a lien" upon all deposits of the maker of the note. The court further held that the bank did not receive a new benefit when it set off the depositor's account against his note and that the right of setoff was not lost by the payment of other checks drawn on the account after the assignment to the bank took place.

The question of whether an assignment which is written to operate in the future divests the assignor of all rights in the property assigned has been answered differently by various courts, depending on the circumstances and applicable state law. *Compare United States v. Trigg*, 465 F.2d 1264 (8th Cir. 1972), *cert. denied*, 410 U.S. 909, 93 S.Ct. 963, 35 L.Ed.2d 270 (1973), *with Monroe Banking & Trust Co. v. Allen*, 286 F.Supp. 201 (N.D.Miss.1968). The statements in the opinions of the Supreme Court of Georgia that the assignee banks are entitled to a "preference" or have a "lien" on the borrower's account are inconsistent with the arguments of the banks in this case that after the assignments the borrower-depositors had no property interests in their accounts. It would be anomalous to hold one entitled to a preference with respect to, or a lien upon, property of which he was the sole and absolute owner. The alternative finding of the district court in No. 3571 that "the Bank in this case had a contractual lien and security interest in the deposit. . ." is likewise inconsistent with the court's finding that the assignment from the depositor to the bank divested B&G of all property and rights to property in the deposit. If the bank was the sole owner of the deposit, it could not have a lien or security interest in it. If indeed the assignments created only rights to a preference or liens, then some property or rights to property remained in the depositors and the issue between the parties is one of priority of liens. However, the claim of a prior lien may not be interposed as a defense to an action to enforce a tax levy. *Commonwealth Bank v. United States*, 115 F.2d 327 (6th Cir. 1940); *United States v. Trans-World Bank*, 382 F.Supp. 1100, 1105 (C.D.Cal.1974). The banks may litigate the priority of

liens issue in an action under 26 U.S.C. § 7426. Federal law is applied in determining property and such considerations as the chronology of the various steps taken by each of the parties and the "choateness" of the assignments are relevant. *See United States v. Pioneer American Insurance Co.*, 374 U.S. 84, 87, 83 S.Ct. 1651, 10 L.Ed.2d 770 (1963); *Hammes v. Tucson Newspapers, Inc.*, 324 F.2d 101, 103 (9th Cir. 1963).

Aside from the assignments the banks contend they were entitled to the benefit of a setoff of the balances in the Best and B&G accounts against the indebtedness of each depositor. An examination of the provisions of the notes relating to setoff reveals that they speak of some positive act by the banks to effect setoff. In both instances the notes provide "the Holder may . . . appropriate and apply" the balances, credits, deposits and accounts of the borrower to his indebtedness. In No. 2549 the bank did not attempt to apply the Best balance to his debts until May 4, 1973, the day following service of notice of levy. In No. 3571 the setoff was made "immediately after" the notice of levy was served. Since the contractual right of setoff required some discrete act by the banks and neither bank in the present cases performed such an act until after service of notice of the levy, the depositors retained property interests in the accounts subject to levy, unless these interests had been extinguished by operation of law.

We again look to state law to determine whether the existence of an indebtedness to the bank which exceeds the balance in a depositor's account divests that depositor of all property and rights to property in the account. Whatever may be the law in other

states,[2] the law of Georgia does not seem to provide for an automatic setoff between bank and depositor. In *Taylor v. Jordan*, 57 Ga. App. 285, 195 S.E. 215, 216 (1938), the court stated that "[m]utual demands extinguish each other by operation of law, without waiting for any act of the parties." Neither the *Taylor* case nor the two older Georgia cases cited in the briefs involved mutual debts of a bank and its depositor who was permitted to withdraw from his account after the mutual obligations came into existence. No Georgia case has been found which holds that a setoff by operation of law occurs where indebtedness of a bank depositor exceeds the balance of his deposits. On the other hand, Georgia cases involving the right of banks to set off debts against depositors' accounts uniformly indicate the requirement of some positive act. *E. g.*, "The bank's *action* . . ." (*Hadarits*, supra, 143 S.E.2d at 629); "When a bank which holds a note against one of its depositors *charges it up* . . ." (*Davenport v. State Banking Co.*, 126 Ga. 136, 54 S.E. 977 (1906)); ". . . having *exercised* this right . . ." [to set off] (*Caye v. Milledgeville Banking Co.*, 91 Ga.App. 664, 86 S.E.2d 717 (1955)). (emphasis added in each quotation). Moreover, the Uniform Commercial Code provision for setoff by banks, effective in Georgia since 1962, uses language connoting the necessity for some positive act on the part of the bank. "Any . . . setoff *exercised* by a payor bank . . ." (emphasis added) Ga.Code § 109A-4-303(1). *Compare Baker v. National City Bank of Cleveland*, 511 F.2d 1016 (6th Cir. 1975).

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2 *See United States v. National Bank of Commerce*, 246 F.Supp. 597 (E.D.La.1965), for discussion of the statutory provision for "compensation." *But see United States v. First National Bank of Commerce* (No. 72-247, E.D.La.1973), *aff'd per curiam*, 493 F.2d 1228 (5th Cir. 1974).

In *United States v. First National Bank of Arizona*, 348 F.Supp. 388, 389 (D.Ariz.1970), *aff'd per curiam*, 458 F.2d 513 (9th Cir. 1972), the District Judge wrote —

> Until a bank has notified its depositor and then *exercised* its right of setoff, the depositor is free to withdraw from his account and it is inconceivable that Congress, by virtue of 26 U.S.C. § 6323, intended to prohibit the Government from levying on that which is plainly accessible to the delinquent taxpayer-depositor (emphasis in original).

A similar view was expressed by the Second Circuit in *United States v. Sterling National Bank & Trust Co. of N.Y.*, 494 F.2d 919, 921-22 (1974).

We do not believe that *United States v. Bank of Shelby*, 68 F.2d 538 (5th Cir. 1934), relied on by the banks in the present case leads to a contrary conclusion. In *Bank of Shelby* the depositor was insolvent and the bank account upon which the government sought to levy constituted the balance of proceeds of the very loan which the bank offset. The court held that ". . . where the mutual obligations have grown out of the same transaction, insolvency on the one hand justifies the set-off of the debt due upon the other" (quoting from *Scott v. Armstrong*, 146 U.S. 499, 507, 13 S.Ct. 148, 36 L.Ed. 1059 (1892)). *Id.* at 539.

We conclude that the government was entitled to judgments enforcing its levies in both cases before us because Best and B&G had property or rights to property in their respective bank accounts. As has been noted, both banks have argued that even if the

depositors had property or rights to property in the accounts upon which levies were made, the banks had liens thereon which were superior to those of the government. The priority of liens is not before the court and we express no views on this issue.

In No. 2549 the government sought a 50 per cent penalty as provided in 26 U.S.C. § 6332(c)(2) for failure of the bank to surrender property of the taxpayer "without reasonable cause." The district court did not reach this issue, but we conclude that there was a bona fide dispute as to whether the deposit represented property or rights to property of Best and that the penalty provision is not applicable in this case.

The judgment in each case is reversed and the cases are remanded to the district courts for entry of judgments for the government.

In the United States District Court
For the Middle District of Georgia
Macon Division

UNITED STATES OF AMERICA,
Plaintiff,

versus CA No. 74-43-MAC

CITIZENS AND SOUTHERN NATIONAL BANK,
Defendant.

OPINION

The issue to be determined in this case is the relative priority of the claims of the parties with respect to a bank deposit. The United States of America (herein "Government"), claims to be the prior claimant to the deposit because of its status as a lienor for taxes withheld and FICA taxes due by the depositor. The Citizens and Southern National Bank (herein "Bank") contends that it is entitled to the deposit for a number of reasons.

A stipulation of facts has been entered into by the parties and is part of the record in this case and the facts in summary are:

B&G Wrecker and Salvage Service, Inc. (herein "B & G") was incorporated on March 19, 1968 and on the following day obtained a loan from the Bank in the amount of $32,496.00 payable in 60 monthly installments beginning April, 1968. B & G executed to

the Bank a collateral installment note, the note containing among other things the following provision:

> The Holder may, at any time, without demand or notice of any kind, appropriate and apply toward the payment of the Liabilities [i.e. the indebtedness by B&G to the Bank], and in such order of application as the Holder may from time to time elect, any balances, credits, deposits, accounts, items or monies of the undersigned with the Holder.

On that same date B & G executed to the Bank five security agreements giving the Bank a security interest in certain assets of B & G, including accounts receivable, equipment and inventory. A life insurance policy on the life of one of the principals of B & G was also assigned to the Bank and two of the principals executed their individual guaranties of the account. All of these security interests were duly perfected by the filing of a financial statement. Also on this same date one of the principals of B & G executed a deed to secure debt on certain real estate, which deed was duly recorded. Also on this same date, March 20, 1968, B & G opened a checking account with the Bank and executed a deposit agreement which contained among other provisions the following:

> To secure any and all indebtedness and liability of Depositor to Bank, however and whenever incurred or evidenced, whether direct or indirect, absolute or contingent, due, or to become due, Depositor hereby transfers and conveys to Bank all balances, credits,

> deposits, monies and items now or hereafter in this account and Bank is authorized at any time to charge such indebtedness or liability against this account, whether or not the same is then due, and the Bank shall not be liable for dishonoring items where the making of such a charge or charges results in there being insufficient funds in Depositor's account to honor such items.

The first installment which was due to have been paid by B & G was not paid on time and in fact no installment was ever paid on time. The bank records show that credits to the account after April, 1969 were made as the result of set-off of the bank account or by liquidation of certain of the collateral held as security.

On June 10, 1969, the Government assessed taxes against B & G in an amount in excess of $10,000.00 and gave notice of the assessment to B & G. The taxes were not paid and have not yet been paid by B & G. On June 13, 1969 notice of the federal tax lien was filed in the office of the Clerk of the Superior Court of Bibb County, Georgia, and ten days later, on June 23, 1969, a notice of levy was served by the Government on the Bank. This was the first knowledge which the Bank had of the tax assessment and at the time of the levy on June 23, 1969 there was on deposit in the checking account of B & G the sum of $1,977.38. Upon receipt of notice of the levy the Bank immediately made a set-off of the balance in the bank account against the indebtedness due by B & G to the Bank, the set-off being $1,977.38.

At all times material to a consideration of this matter B & G was indebted to the Bank in a sum in excess of the amount on deposit and the Bank ultimately had a loss to be charged off because a complete liquidation of the collateral was insufficient to pay the indebtedness.

The Government contends that the B & G bank account was subject to levy by it, and the Bank took the position that the bank account was not subject to levy. This litigation ensued.

Sections 6321 and 6323 of the Internal Revenue Code make it clear that the tax liens imposed by §6321 "shall not be valid as against any . . . holder of a security interest . . . until notice thereof . . . has been filed by the Secretary or his delegate", and that the term " 'security interest' means any interest in property acquired by contract for the purpose of securing payment or performance of an obligation or indemnifying against loss or liability" and that a "security interest exists at any time if, at such time, the property is in existence and the interest has become protected under local law against a subsequent judgment lien arising out of an unsecured obligation, . . .". Thus, while federal law establishes the Government lien against the taxpayer, the Government in reality can stand in no better position than the taxpayer himself as against the claims of a third party, and the question of what is "property" or what are "rights to property" must be determined by local or general law.

It will be noted that in §6323 of the Internal Revenue Code the effect of the Government's lien is limited and

the Supreme Court has said in *Aquilino v. United States*, 363 U.S. 509 (1960):

> "The threshold question in this case, as in all cases where the Federal Government asserts its tax lien, is whether and to what extent the taxpayer had 'property' or 'rights to property' to which the tax lien could attach. In answering that question, both federal and state courts must look to state law, for it has long been the rule that 'in the application of a federal revenue act, state law controls in determining the nature of the legal interest which the taxpayer had in the property . . . sought to be reached by the statute.' " (pp. 512, 513)

In *Stuart v. Willis*, 244 F.2d 925 (9 Cir. 1957), the Court said:

> "It is one of the principles which must necessarily be observed in the law of taxation as in other fields that the rights and property of third persons must be respected." (p. 929)

and in *United States v. Winnett*, 165 F.2d 149 (9 Cir. 1947), the Court stated that:

> ". . . the rights of the Collector (of Internal Revenue) do not extend beyond those of the taxpayer whose right to property is sought to be levied upon." (p. 151)

Thus, if under Georgia law B & G had no right to demand the funds represented by its bank deposit

because of the lien which existed in favor of the Bank prior to the Government's levy, then the Bank's interest in the deposit would be superior to that of the Government.

Under Georgia law a general bank deposit is neither property nor a right to property. It simply establishes the relationship of debtor and creditor between the Bank and the depositor. In Georgia when money is placed in a bank on general deposit the title to the money immediately passes to the Bank and the depositor simply has a claim against the Bank, which claim is not considered 'property' or a 'right to property'. See *Davenport v. State Banking Company, 126 Ga. 136 (1906), and Ricks v. Broyles, 78 Ga. 610 (1887), and McGregor v. Battle, 128 Ga. 577 (1907), and Foster v. Peoples Bank, 42 Ga. App. 102 (1930).*

At the time the Government levy was made in this case B&G had no claim of any nature which it could have successfully asserted against the Bank because the indebtedness of B&G to the Bank was greater than any sum on deposit. If it had asserted any claim against the Bank the counterclaim of the Bank would have been greater and there is federal authority based in part upon Georgia law that if a bank either at law or in equity can defeat a demand by a depositor, since the Government's lien rights are derivative of those of the depositor, the Government takes subject to the defenses and equities affecting the depositor, so that even if the depositor has a claim, if it is not a claim which could have been maintained successfully by him, the Government is in no better position. *United States v. Bank of Shelby, 68 F.2d 538 (5 Cir. 1934).*

In this connection it has been stipulated by the parties that at the time the Bank applied the balance in the account of B & G to its indebtedness the indebtedness of B & G to the Bank was mature and demandable.

From the foregoing it follows that under the circumstances here presented the B & G bank deposit was neither property nor right to property, nor even a claim upon which the Government could levy. The decision of the Court in the *Bank of Shelby* case above referred to recognizes the common law right of set-off and the contractual right of set-off which could be asserted by the Bank against the depositor in circumstances of the nature here presented, and further, that this set-off could be made by the Bank either before it had knowledge of the Government's tax lien or after it became aware of it.

There is yet another reason why the Government's lien cannot be accorded priority status in this case. Georgia law gives to banks a lien on deposits of its customers who are indebted to them and this is true even in the absence of any contractual arrangement. *Mutual Reserve Life Insurance Company v. Fowler, 2 Ga. App. 537 (1907).* In addition, the Bank in this case had a contractual lien and security interest in the deposit which was created by the instruments taken by the Bank at the time the account was opened by the depositor. The deposit agreement between B & G and the Bank contained a specific transfer and conveyance of bank deposits as security for the loan by the Bank to B & G. *Macon National Bank v. Smith, 170 Ga. 332 1930); W. C. Cave & Co., Inc. v. Milledgeville Banking Company, 91 Ga. App. 664 (1955).* The Court of Appeals

for the Fifth Circuit has given effect to such contracts as against the claim of the United States under a federal tax lien. *Community State Bank of Independence v. United States, 493 F.2d 908 (1974).* The principle recognized in these cases seems to be particularly appropriate for application to the facts of this case because here the taxes for which the Government's lien is claimed had not even accrued at the time the Bank acquired its security interest in the deposits, and it is abundantly clear that the Bank was intended to be and was in fact and in law a secured creditor holding a lien or security interest.

For the reasons above outlined the Court concludes that the lien asserted by the Government cannot be supported and that judgment should be entered for the Defendant. The Clerk will enter judgment accordingly.[1]

This 28th day of July, 1975.

/s/ J. ROBERT ELLIOTT
UNITED STATES
DISTRICT JUDGE

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1 This ruling makes it unnecessary for the Court to give consideration to the constitutional questions raised by the Defendant's answer and brief.

United States Court of Appeals
For the Fifth Circuit

No. 75-3571

D. C. Docket No. CA 74-43-Mac

UNITED STATES OF AMERICA,
Plaintiff-Appellant,
versus

CITIZENS AND SOUTHERN NATIONAL BANK,
Defendant-Appellee.

Appeal from the United States District Court for the Southern District of Georgia

Before WISDOM, GODBOLD and LIVELY*, Circuit Judges.

JUDGMENT

This cause came on to be heard on the transcript of the record from the United States District Court for the Southern District of Georgia, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, reversed; and that this cause be, and the same is hereby remanded to the said District Court in accordance with the opinion of this Court;

* Of the Sixth Circuit, sitting by designation.

It is further ordered that defendant-appellee pay to plaintiff-appellant, the costs on appeal to be taxed by the Clerk of this Court.

September 15, 1976

Issued as Mandate:

United States Court of Appeals
Fifth Circuit

November 16, 1976

TO ALL COUNSEL OF RECORD

NOS. 75-2549 & 75-3571 — USA v. Citizens and Southern National Bank

Dear Counsel:

This is to advise that an order has this day been entered denying the petition for rehearing, and no member of the panel nor Judge in regular active service on the Court having requested that the Court be polled on rehearing en banc (Rule 35, Federal Rules of Appellate Procedure; Local Fifth Circuit Rule 12) the petition for rehearing en banc has also been denied.

See Rule 41, Federal Rules of Appellate Procedure for issuance and stay of the mandate.

Very truly yours,

EDWARD W. WADSWORTH,
Clerk

/s/ SUSAN M. GRAVOIS
Deputy Clerk

/smg
cc: Mr. John D. Carey
Mr. Scott P. Crampton
Mr. Gilbert E. Andrews
Mr. E. S. Sell, Jr.
Mr. Charles T. Zink
Mr. Edmund A. Booth, Jr.
Mr. William M. Fulcher

STATUTES

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 6321. LIEN FOR TAXES.

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

SEC. 6323 [as amended by Sec. 101(a), Federal Tax Lien Act of 1966, *supra*]. VALIDITY AGAINST MORTGAGEES, PLEDGEES, PURCHASERS, AND JUDGMENT CREDITORS.

(a) *Purchases* [*Purchasers*], *Holders of Security Interests, Mechanic's Lienors, and Judgment Lien Creditors.* — The lien imposed by section 6321 shall not be valid as against any purchaser, holder of a security interest, mechanic's lienor, or judgment lien creditor until notice thereof which meets the requirements of subsection (f) has been filed by the Secretary or his delegate.

(b) *Protection for Certain Interests Even Though Notice Filed.* — Even though notice of a lien imposed by section 6321 has been filed, such lien shall not be valid —

* * *

(h) *Definitions.* — For purposes of this section and section 6324 —

(1) *Security interest.* — The term "security interest" means any interest in property acquired by contract for the purpose of securing payment or performance of an obligation or indemnifying against loss or liability. A security interest exists at any time (A) if, at such time, the property is in existence and the interest has become protected under local law against a subse-

quent judgment lien arising out of an unsecured obligation, and (B) to the extent that, at such time, the holder has parted with money or money's worth.

* * *

6331. LEVY AND DISTRAINT.

(a) *Authority of Secretary or Delegate.* — If any person liable to pay any tax neglects or refuses to pay the same within 10 days after notice and demand, it shall be lawful for the Secretary or his delegate to collect such tax (and such further sum as shall be sufficient to cover the expenses of the levy) by levy upon all property and rights to property (except such property as is exempt under section 6334) belonging to such person or on which there is a lien provided in this chapter for the payment of such tax. Levy may be made upon the accrued salary or wages of any officer, employee, or elected official of the United States, the District of Columbia, or any agency or instrumentality of the United States or the District of Columbia, by serving a notice of levy on the employer (as defined in section 3401(d)) of such officer, employee, or elected official. If the Secretary or his delegate makes a finding that the collection of such tax is in jeopardy, notice and demand for immediate payment of such tax may be made by the Secretary or his delegate and, upon failure or refusal to pay such tax, collection thereof by

levy shall be lawful without regard to the 10-day period provided in this section.

* * *

SEC. 6332. SURRENDER OF PROPERTY SUBJECT TO LEVY.

(a) [as amended by Sec. 104(b)(1), Federal Tax Lien Act of 1966, *supra*]. *Requirement.* — Except as otherwise provided in subsection (b), any person in possession of (or obligated with respect to) property or rights to property subject to levy upon which a levy has been made shall, upon demand of the Secretary or his delegate, surrender such property or rights (or discharge such obligation) to the Secretary or his delegate, except such part of the property or rights as is, at the time of such demand, subject to an attachment or execution under any judicial process.

* * *

(c) [as added by Sec. 104(b)(4), Federal Tax Lien Act of 1966, *supra*]. *Enforcement of Levy.* —

(1) *Extent of personal liability.* — Any person who fails or refuses to surrender any property or rights to property, subject to levy, upon demand by the Secretary or his delegate, shall be liable in his own person and estate to the United States in a sum

equal to the value of the property or rights not so surrendered, but not exceeding the amount of taxes, for the collection of which such levy has been made, together with costs and interest on such sum at the rate of 6 percent per annum from the date of such levy. Any amount (other than costs) recovered under this paragraph shall be credited against the tax liability for the collection of which such levy was made.

* * *

Georgia Code Annotated:

85-1803. (3653) Assignment of choses in action arising upon contract. — All choses in action arising upon contract may be assigned so as to vest the title in the assignee, but he takes it, except negotiable instruments subject to the equities existing between the assignor and debtor at the time of the assignment, and until notice of the assignment is given to the person liable.

(Acts 1952, pp. 225, 229.)